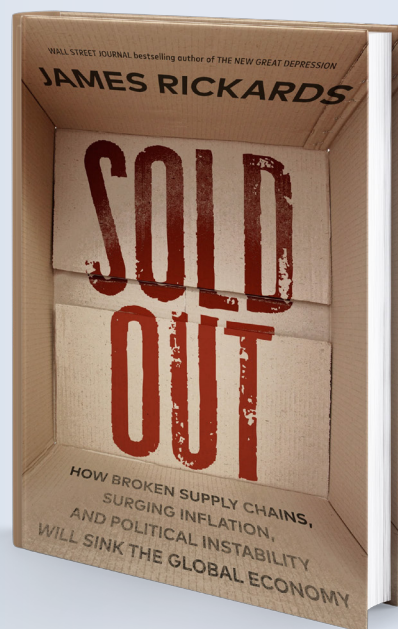


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Sold Out

How Broken Supply Chains, Surging Inflation, and Political Instability Will Sink the Global Economy

By James Rickards

James Rickards is the Editor of Strategic Intelligence, a financial newsletter, and the bestselling author of *The New Great Depression*, *Aftermath*, *The Road to Ruin*, and many more. He is an investment advisor, lawyer, inventor, and economist, and has held senior positions at Citibank, Long-Term Capital Management, and Caxton Associates.

Contemplating the Supply Chain Crisis

James Rickards, in his book, *Sold Out: How Broken Supply Chains, Surging Inflation, and Political Instability Will Sink the Global Economy*, tells his reader that supply chains are nothing new. He discusses a sunken ship that is dated back to 1300 B.C. The ship contained much cargo including food, tin, art, lavender, and weapons, among other objects. This ship followed a well known trade route of the time and the items originated from and were destined for numerous different locations including Egypt, Syria, and Greece. Of this trade, Rickards says that it may not be as efficient or quick as the Amazon Prime many rely on today, but its purpose was the same, to match supply and demand.

In the years since 1300 B.C. supply chains and trade routes have changed and been altered due to sociopolitical circumstances and technological advances around the world. Supply chains are tied to military successes and failures to the point that Chinese military threats are currently “tempered by the reality that China has no oil or natural gas, and their maritime supply lines can easily be shut down.” Covid 19, according to Rickards, has proven to be a major challenge to supply chains around the world. He goes on, however, to say that supply chain breakdowns today are greater than those experienced at the beginning of the pandemic.

Rickards poses and attempts to answer the question, “If there’s nothing new about global supply chains, why the frantic headlines?” While supply chains have been around for centuries, modern supply chain management and the capability to closely track and manage supply chains is relatively new. The study of supply chains has led to innovations such as “just-in-time inventory, intermodal transportation, overnight delivery, cross-docking, radio frequency identification, GPS tracking, and more” according to Rickards.

Supply chains have become much more efficient as the result of all of these advancements, but this efficiency comes at the price of increased risk. For example, when just-in-time delivery is utilized, entire plants can shut down when needed materials do not arrive on time. For Rickards, redundancy provides security, and a lack thereof takes away security. Failures can and have cascaded and have put the world in the position it is in today where shelves are empty and inflation is high. As Rickards says,

“Any system that scales too far will collapse of its own weight.” He sees the world at being at a state where Supply Chain 1.0 is over, but Supply Chain 2.0 has not yet been developed.

The Global Supply Chain

The first topic Rickards addresses in detail is the global supply chain. Rickards says that the supply chain “is just a name we give to a nexus of logistics, inputs, processes, transportation, packaging, distribution, marketing, customer relations, vendor relations, and human capital that in the aggregate supports the supply and demand for every physical, digital, intellectual, or artistic artifact on the planet and in space. The supply chain is everywhere.” Consumers have become accustomed to the supply chain working quickly, cheaply, and efficiently, and as such, consumers have the luxury of the items they want being where they need them when they expect them. Consumers, however, are able to observe some of the breakdown in the system as expected items are not always on the shelves or in people’s mailboxes when they expect them.

Rickards explains that there is an entire endless process that must go according to plan if consumers are to avoid empty shelves in the stores. Most of this is unseen by the consumer because there are backups for when one chain breaks down. These supply chains contain not only truck drivers and warehouse workers, but also farmers, seed providers, raw material providers, and countless other links often from around the world. To illustrate just how endless supply chains are, one could think of bread on the shelves. Not only is the wheat grower and baker part of that supply chain, but so are the people who fix the ovens and those who mine and develop the tools and parts necessary to fix the ovens when they break down. In addition, energy must be sourced to the baker and the shop that is selling the bake. The extended supply chain is endless according to Rickards.

Rickards explains that not all supply chains are “spread among numerous suppliers and logistics providers. In fact, one of the most extensive supply chains in history was confined to a single firm - the Ford Motor Company between 1927 and 1940.” At that time, Ford attempted to confine everything it needed to its own company, eliminating the need to rely on outside companies. This is not, however, how most supply chain managers run business today. In fact, it is looked down on.

Customer satisfaction and low cost are seen as the primary goal of supply chain management, and those goals can be best achieved by using as many suppliers as necessary, aided by supply chain technology to manage it all. This leads to optimal efficiency. Unfortunately efficiency requires accurate assessment of supply and demand, and this is simply not always possible. Rickards then goes on to explain numerous companies currently experiencing difficulties with their supply chain. According to Rickards, this is an international problem.

Rickards discusses some effects of these supply chain problems apart from empty shelves. One of these is inflation which he discusses in detail in the second half of his book. Another is

skimpification. Here companies offer fewer services for the same price. He considers this to be inflation by another name because the consumer gets less product or service for the same price.

Rickards does believe that supply chains can be mended, but this cannot be done through merely remediating the problem. Instead, the supply chain needs to be “rebuilt along new lines.” He believes this new supply chain, which he calls Supply Chain 2.0, will require at least five years and it will not look much like Supply Chain 1.0. He then goes into detail discussing the many causes of the breakdown that led to a backup of cargo outside of the Port of Los Angeles, showing just how many factors were at play in the breakdown. Among many other factors that led to the breakdown are loading and unloading capacity, political moves, and trucking shortages which were exacerbated by both the pandemic and a shortage of young drivers hesitant to enter the field due to the emergence of self-driving trucks.

To describe how the supply chain broke, Rickards says, it was “gradually at first, climaxed by a sudden catastrophic collapse.” He dates the beginning of the breakdown to January 23, 2017 when then President Trump officially withdrew the country from the Trans-Pacific Partnership. This began trade wars, and Trump imposed large tariffs just about a year later primarily aimed at China. Eventually tariffs were implemented by China, the EU, and Canada against the United States. Many of the tariffs did not go into effect immediately, and this caused importers to try to get as many supplies in before the tariffs went into effect, and this began the process that eventually led to where the country was in 2021 with empty shelves.

The trade wars were not the only factor, however. Rickards also blames the constant search for efficiency which ultimately leads to bottlenecks when problems emerge. Trump’s decisions were not the only ones that led to the crisis according to Rickards. He points to numerous choices by the Biden administration, especially vaccine requirements, as contributing to the problem.

Energy was another cause in the supply chain breakdown. As operations scale up, the need for energy scales up “by a factor of five.” Increased energy needs cause problems when shortages occur. They also arise because the increased energy increases either the cost to consumers or the profit margins for producers. In short, Rickards says, “the hidden cost of efficiency is vulnerability.” He believes that the redundancy which efficiency eschews actually serves as insurance and can save businesses from ruin. The current system is complex, and it will collapse in his estimation. Rickards provides an entire chapter on the reasons why the supply chain problems will persist. Some of these reasons are the handling of the pandemic, new green policies, and geo-economics, especially as it pertains to Russia and China.

The Role of Money

The next topic Rickards broaches is that of money and inflation, and he starts out this section with the startling statistic that the US Labor Department in July of 2022 said that the consumer price index rose by 9.1 percent, the highest it had been since November of 1981. Year over year between 2020 and 2021, “gas-



... proper investment will cause increased productivity, which will subdue inflation.”

line prices rose 49.6 percent, natural gas prices rose 24.1 percent, energy prices rose 29.3 percent.” The prices on food and vehicles rose greatly as well. Prices rose not only in the United States but around the world. While inflation was quite high compared to the rest of the 21st century, the rates are not as high as they were for significant portions of the 1970s and 1980s.

The question that Rickards believes people need to consider is if the current inflation is transitory or if it is the beginning of another long inflationary stretch like that that occurred in the 70s and 80s. He lists five causes for the inflation of that time period: Vietnam War and Great Society spending, the Baby Boomers coming of age, the end of the gold standard, the resignation of President Nixon, and the Arab oil embargo. In regards to the response to all of this by Federal Reserve Chairman, Paul Volcker, Rickards says that his policies helped bring inflation down, but it put the economy into a recession.

Rickards discusses velocity as “the first and most important system element.” Velocity refers to the turnover of money. In other words, it measures how quickly people spend their money. Velocity has been collapsing since 2008 because as incomes fall, savings rise and less money is “available for consumption.” He then discusses base effects. Inflation is examined by looking at one month compared to that month in the year prior. An increase in inflation after a year of quite low inflation is called base effect.

Rickards then goes on to list “five factors that may cause higher inflation: deficits, demographics, monetary policy, politics, and supply shocks.” In terms of deficits, Rickards is concerned with the debt to GDP ratio as sometimes countries with a high debt to GDP ratio can quickly move from disinflation to hyperinflation. With regards to demographics, Rickards points to how many countries people are no longer reproducing at a rate to replace those currently alive. This will lead to an aging population that needs to be taken care of. Some say this decrease in population could result in deflations and others say it could result in inflation. Rickards believes it is likely to lead to slow inflation. The third factor that Rickards discusses is monetary policy. While many believe that monetary policy will likely cause short-term inflation, Rickards believes that it could either have no inflationary impact or it could actually lead to disinflation. He believes that the fourth factor, politics, has had an inflationary impact, but this impact could be short-lived. When discussing politics, he goes into detail on the different stimulus packages provided by the government during the pandemic and the effects these packages had.

The final factor he discusses are supply shocks. He gives the example of the Arab oil embargo of the previous century to explain how supply shocks can be so drastic that consumers may

not be able to get oil at the pump. He believes that the pandemic, trade wars, and supply chain breakdown may be causing a new supply side breakdown.

In his next chapter, Rickards discusses the difference between disinflation and deflation. Disinflation occurs when inflation is still occurring but at a slower rate. Deflation occurs when prices actually go down. He claims that both of these “point toward higher real rates, slower growth, and deferred or diminished consumption.” He believes that proper investment will cause increased productivity which will subdue inflation. If investment is not done wisely, there will be an increase in debt-to-GDP which will also subdue inflation. The first will result in a success for all involved whereas the second will result in weaknesses.

Rickards’ book ends discussing some proposals for improving the state of affairs going forward. One of these solutions is for countries to gather together with allies in a College of Nations that works with each other as trusted allies in the supply chain. This would increase prices likely but these prices could also be mitigated with enhanced technology. Key to improved supply chains is also a need for price stability and policy consistency. He says, “The best case is that inflation fades without a monetary policy blunder on the way. That’s a slim reed to lean on.” He does not trust the Fed to make appropriate decisions.

In his book, Rickards presents what he sees as the causes of the current state of affairs with inflation and with the supply chain. He lays the blame not with one particular party or policy as he relates how decisions made by both the current and the previous administration have led to some of these effects. He is quick to say how he believes the handling of the pandemic played a large role in establishing the situation the world is currently facing. Still, he believes there is hope for the future but that it will not be an easy road to get there as some systems will need to be completely rehauled.

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